ENCLOSURE 1

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

September 13, 1999

The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
House of Representatives
Washington, D.C. 20515-6115

Dear Congressman:

Thank you for your letter concerning certain insurance issues associated with H.R. 10, the financial modernization bill that passed the House in July. The enclosure provides detailed responses to the questions posed in your letter.

As an initial matter, I would like to reaffirm the Board's support of Congressional efforts to modernize the nation's financial laws. It is important that Congress act now to set the rules that will govern the evolution of our financial system in the 21st century. It is equally important, however, that Congress establish a structural framework for modernization that best protects insured depository institutions, the federal deposit insurance funds and the American taxpayers, prevents the spread of the federal safety net, ensures a fair and level competitive playing field for all financial service providers, increases consumer choice, and relies on strong principles of functional regulation.

The Board is strongly of the view that the holding company framework—and not the operating subsidiary approach—best achieves these fundamental objectives. The questions raised in your letter highlight some of the risks that may arise from permitting operating subsidiaries of banks to engage in potentially volatile principal activities, such as insurance underwriting and reinsurance activities.

I hope these comments and the enclosed responses are useful.

Sincerely,

Alan Greenspan

Enclosure

1. *Do you have concerns about legislation that would permit a bank, directly or in a subsidiary of the bank, to engage in reinsurance activities? How would your concerns be affected if the legislation in question also exempted such a bank or subsidiary of the bank from having to comply with the requirements of an insurance regulator? Please explain.*

The Board has grave concerns with legislation that would permit insured banks to provide insurance, including reinsurance, either directly or through a subsidiary, or that would not be consistent with the principle of functional regulation. Allowing banks, directly or through operating subsidiaries, to engage in insurance underwriting and reinsurance activities would permit banks to fund these activities with low-cost funds raised through the benefit of the federal safety net. This would provide banks or their subsidiaries with a significant funding advantage over their competitors in the insurance field and inevitably lead to weakened competition in the market for insurance products. In addition, as described further below, allowing banks or their operating subsidiaries to engage in potentially volatile activities such as insurance underwriting or reinsurance activities would pose serious risks to the safety and soundness of banks and the deposit insurance funds.

Section 304 of H.R. 10 would prohibit a national bank from providing insurance in any state, either directly or through an operating subsidiary. (The Federal Deposit Insurance Act already generally prohibits insured state banks from engaging in insurance underwriting activities either directly or through a subsidiary.) Because reinsurance is regulated by the states as insurance and insures, guarantees, or indemnifies the ceding insurance carrier against liability under the underlying policies, we believe that the current language of H.R. 10 is intended to prohibit a national bank or an operating subsidiary of a national bank from engaging in reinsurance activities in any state.

We understand that other interested parties, including certain state insurance regulators, have expressed concern that the current language of H.R. 10 may not clearly prohibit national banks and their subsidiaries from engaging in reinsurance activities. Some also have expressed concern that the reference in H.R. 10 to providing insurance as principal "in a State" might be construed to allow a national bank or its subsidiaries to engage through offshore branches, offices or subsidiaries in reinsuring policies sold in the United States. We believe that H.R. 10 intends to cover these type of offshore reinsurance activities within its prohibition on providing insurance as principal. We also believe that the risks of allowing a bank or its subsidiaries to conduct reinsurance activities are too great to allow any doubt about the scope of this prohibition, or about whether any reinsurance activities that might be permitted are subject to appropriate functional regulation. The Board would be happy to work with Congressional staff and others to clarify the bill's clear intent to prohibit national banks and their operating subsidiaries from engaging in reinsurance activities.

2. Are there any insurance activities, other than sales, that you believe a bank should be able to conduct directly or in a subsidiary of the bank? If there are, should these non-sales activities be subject to insurance regulations that normally apply to such activities?

H.R. 10 would allow national banks and operating subsidiaries of national banks to continue to provide as principal those insurance products that national banks were lawfully permitted to provide as of January 1, 1999, except title insurance and annuities. These permissible products primarily consist of credit-related insurance products. Significant regulatory problems have not arisen to date with the provision of these limited types of insurance by banks.

In addition, H.R. 10 would permit national banks to provide as principal new forms of traditional banking products that may in the future be characterized as insurance under state law unless the product is treated as insurance under the Internal Revenue Code. These provisions appear appropriately limited and carefully balanced.

3. Reinsurance is a particularly risky activity. A major reason cited for the huge estimated losses in the recent Unicover case (at least $1.3 billion) is that an off-shore agent obligated the Unicover reinsurance pool for far more risk than participants in the pool had intended to assume. If banks, rather than life insurance companies, constituted the participants in the Unicover reinsurance pool, is there anything that would prevent this $1.3 billion loss from having to be absorbed by the banks' depositors and/or federal guaranty funds? If not, what are the implications for the safety and soundness of the banking system, if banks were to incur losses like those of the participants in the Unicover reinsurance pool?

If insured banks, either directly or through operating subsidiaries, were permitted to engage in insurance underwriting activities (including reinsurance activities), then any losses from these activities would have a direct negative impact on the consolidated financial condition of the bank and ultimately could result in substantial losses to the federal deposit insurance funds and the American taxpayer.

It is essential that banking organizations be permitted to engage in the newly authorized principal activities, such as insurance underwriting and reinsurance activities, only outside the bank and through a separate corporate entity for which the bank is not financially or managerially responsible and that is subject to appropriate functional regulation. Such a structure best ensures that the new activities will be financed at market rates, that the federal safety net will not be extended beyond its intended scope, and that federally insured banks and the deposit insurance funds will not bear the risks associated with such activities. This structure also more effectively limits the potential conflicts between the banking laws and the existing consumer protection laws and regulatory schemes that currently govern the new activities, including insurance. It is for these reasons that we have argued strongly that the operating subsidiary structure is not the appropriate framework for financial modernization.

As noted above, H.R. 10 would not permit national banks, directly or through an operating subsidiary, to engage in insurance activities as principal. We believe this prohibition also was intended to prohibit national banks and their subsidiaries from engaging in reinsurance activities, including the type of reinsurance activities involved in the Unicover case and, as noted above, would be happy to work with Congressional staff to assure that this prohibition is clearly stated in any financial modernization legislation.

4. An analyst recently said of the Unicover failure that it may cause a return to the notion that reinsurance is a partnership unless "brand new naive capacity comes along." Are you concerned that if legislation allows banks to engage in reinsurance without regulation, banks may become the "brand new naive capacity" that could lead to further reinsurance losses and that could undermine the safety and soundness of banks and the solvency of bank holding companies?

The Board believes the holding company structure better insulates insured banks from the potential riskiness of new activities and best ensures a fair and level playing field for all financial service providers. The protections afforded by the holding company structure are particularly important with respect to insurance underwriting activities, which can be very risky. Reinsurance activities contain all of the risks of insurance underwriting and, in our view, should not be authorized for banks or their operating subsidiaries.

For the reasons discussed above, the Board does not believe that the universal bank or operating subsidiary approach adequately protects our nation's insured banks, the deposit insurance funds, or the financial system from the risks associated with the newly authorized activities and affiliations. This approach to modernization failed both the industry and the taxpayer in the thrift industry and, by allowing the spread of the federal safety net and its related subsidy, would have seriously debilitating consequences for the vitality of competition in the financial services industry. Furthermore, this approach—by allowing a functionally regulated firm to be a direct subsidiary of a federally insured bank—increases the likelihood of conflicts between bank regulation and the functional regulation of the subsidiary's activities.

U.S. House of Representatives
Committee on Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515–6115

July 30, 1999

The Honorable Alan Greenspan
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Chairman:

I am writing to ask your views on whether H.R. 10, the Financial Services Act of 1999, as passed by the House, adequately provides for the regulation of insurance activities which a bank may conduct. As you know, this legislation, which will soon go to conference, permits banks and the subsidiaries of banks and bank holding companies to engage in all insurance activities except underwriting. As with any other entity involved in the business of insurance, the insurance activities that a bank conducts, directly or indirectly, must be regulated appropriately in order to protect consumers, state and federal guaranty funds, and affiliated entities.

Unfortunately, those responsible for insurance regulation in the United States have concluded that, with the exception of underwriting and to a limited extent sales, H.R. 10 does not permit insurance activities conducted by banks to be regulated in the same way that non-bank insurance activities are regulated. According to the National Association of Insurance Commissioners (NAIC), H.R. 10 would preempt state regulation of the insurance activities of banks, whether those activities are conducted directly out of a bank, or by a bank subsidiary or affiliate. Activities this legislation would exempt from regulation include payment of claims to policyholders, reinsurance, investment management of insurance company assets, and the processing of consumer complaints and grievances. Altogether, the NAIC says H.R. 10 would prevent 1,781 existing state insurance laws from being applied to banks. These laws would continue to apply, however, to all other non-banks, or non-bank affiliated entities that engage in insurance.

I am concerned, therefore, that this legislation gives banks a safe haven from insurance regulation. Given the fact that most banks have only limited insurance experience, I am not at all clear why anyone would think the public interest is being served if inexperienced and potentially naive players are permitted to enter, without supervision or regulation, this highly complex financial arena in which the penalty for failure is the direct assumption of huge risk and enormous losses. Too often, even those with far more experience than most banks fail or are unsuccessful in their insurance endeavors, causing much disruption in affiliated entities and exposing policyholders and state guaranty funds to great risk and loss.

Five major life insurance companies recently got saddled with estimated losses of at least $1.3 billion because they were participants in a reinsurance pool (see enclosure) that they failed to properly control or fully understand. This pool provided reinsurance for a type of insurance with which these companies had little experience. Fortunately, a state regulator stepped in and prohibited other life insurance companies from engaging in this type of reinsurance activity. The state regulator was able to take the action he did because state law gave him that authority. However, H.R. 10 would prevent that same state regulator from acting as he did, if a bank were to engage in that reinsurance pool, under the very same circumstances.

Losses from reinsurance are not covered by state insurance guaranty funds. If a bank loses money in a reinsurance venture, the bank will have to absorb that loss. Do we really want banks, whose activities are ultimately underwritten by the American taxpayer, to be exposed to the kind of losses that occur in the business of reinsurance? Is there any good reason for the states not to be able to regulate the risky business of reinsurance just because a bank happens to be involved?

I am certain that is no one's intent. The potential for financial catastrophe, not unlike that experienced when the banks failed during the Great Depression, simply is far too great to risk. Clearly, H.R. 10 raises serious regulatory issues that must be thoroughly evaluated, especially as they impact the safety and soundness of banks and the solvency of bank holding companies. As a result, I would like to have the benefit of your views on this matter and your response to the following questions:

1) Do you have concerns about legislation that would permit a bank, directly or in a subsidiary of the bank, to engage in reinsurance activities? How would your concerns be affected if the legislation in question also exempted such a bank or subsidiary of the bank from having to comply with the requirements of an insurance regulator? Please explain.

2) Are there any insurance activities, other than sales, that you believe a bank should be able to conduct directly or in a subsidiary of the bank? If there are, should those non-sales activities be subject to insurance regulations that normally apply to such activities?

3) Reinsurance is a particularly risky activity. A major reason cited for the huge estimated losses in the recent Unicover case (at least $1.3 billion) is that an off-shore agent obligated the Unicover reinsurance pool for far more risk than participants in the pool had intended to assume. If banks, rather than life insurance companies, constituted the participants in the Unicover reinsurance pool, is there anything that would prevent this $1.3 billion loss from having to be absorbed by the banks' depositors and/or federal guaranty funds? If not, what are

the implications for the safety and soundness of the banking system, if banks were to incur losses like those of the participants in the Unicover reinsurance pool?

4) An analyst recently said of the Unicover failure that it may cause a return to the notion that reinsurance is a partnership unless "brand new naive capacity comes along." Are you concerned that if legislation allows banks to engage in reinsurance without regulation, banks may become the "brand new naive capacity" that could lead to further reinsurance losses and that could undermine the safety and soundness of banks and the solvency of bank holding companies?

I want to thank you for your cooperation and wise counsel. I look forward to hearing from you and request that you provide me with your response no later than the close of business on Wednesday, August 25, 1999. If you have any questions regarding this matter, please call me or have your staff call Bruce Gwinn of the Committee staff at 226-3400.

With every good wish.

Sincerely,

JOHN D. DINGELL
RANKING MEMBER

Enclosure

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IBNR INSURANCE WEEKLY #30 (Volume VI)

Evening of Sunday July 25th, 1999

**** UNICOVER POOL MEMBERS MEETING IN HARTFORD—NO ACTION ON SUN LIFE RETRO RECISSION****

The members of the Unicover *workers' compensation "carve up" (as in retros)* Facilities (the "Pool" & the Lincoln National & Reliance facilities = 3) met in Hartford last Monday. We understand the day long meeting was held in Phoenix Home Life's Board room-- which is one of only three rooms in downtown Hartford large enough to hold all the lawyers who attended (the other two are on HSB's 12th floor). Unfortunately, since all the participants signed confidentiality agreements (and *specifically* agreed not to talk to us), we were unable to determine any details of actions taken (despite numerous local/long-distance phone calls). Among all the "no comments," we were able to glean the fact *the Pool/Facility members undertook governance actions to ensure closer oversight of the Unicover situation going forward* (several committees were established). Further, an *early August date to meet again was scheduled*. Apparently, *no* agreement on how to handle the recent Sun Life retrocessional rescission emerged.

We continue to believe the pool members, and their lawyers, will have great difficulty finding common ground (one huge world-wide Unicover arbitration would suggest the Pool/Facility participants must agree on *one* arbiter—Sun Life picks one and the 3rd is mutually agreed upon) *given the myriad obvious conflicts of interest*:

- *Phoenix*---both a Pool member & a retrocessional participant on the exact terms as Sun Life
- *CIGNA*---both a Pool member & a reinsurer of Cackett/Sun & Phoenix (as a "front" for Odyssey Re)
- *Lincoln National*—Pool member, have their own facility operated by Unicover, and reinsurer of Sun & Phoenix
- *Cologne Life Re*—Pool member and retrocessional participant (admits to up to $250MM of exposure)
- *ReliaStar*—Pool member and engaged in ongoing litigation with AIG over Unicover issues
- *Reliance*---"Fronted" for up to $1.5BB of Unicover premium (multi-year) for which REL appears contractually obligated to perform irrespective of the actions of the various reinsurers.

Phoenix, which given the Sun Life action will be forced to declare its legal loyalties (heads it's the Pool, tail it's the retro?) received welcome favorable/not negative news from A.M. Best last week. *We still believe A.M. Best, as the "defacto regulator" of the insurance industry, may well play a major role in how Unicover related events unfold from here through either their action(s) or lack thereof*.

IBNR INSURANCE WEEKLY #29 (Volume VI)

Evening of Sunday July 18th, 1999

***** SUN LIFE, AFTER MONTHS OF STUDY, ENDS SILENCE AND SEEKS UNICOVER RETRO RESCISSION*****

After months of "no comment" and claims of "no material loss" with respect to any potential "Unicover" exposure, *Sun Life of Canada came to town this week with both barrels blazing*.

(1) Having returned the premium in question to Aon/Unicover, seeks rescission of the Unicover reinsurance contracts.
(2) Suggested, in a Bloomberg interview with its Vice Chairman, *a potential maximum gross loss from Unicover of as much as $700MM*—but claiming its own retrocessional program was still valid and thus the "no material loss" position was still valid. For reference, *the $700MM figure would equate to a reinsurance industry loss of approximately $1.65BB or modestly above our published estimate of "at least" $1.3BB* if all contracts were valid and went "full term"—which appears unlikely.

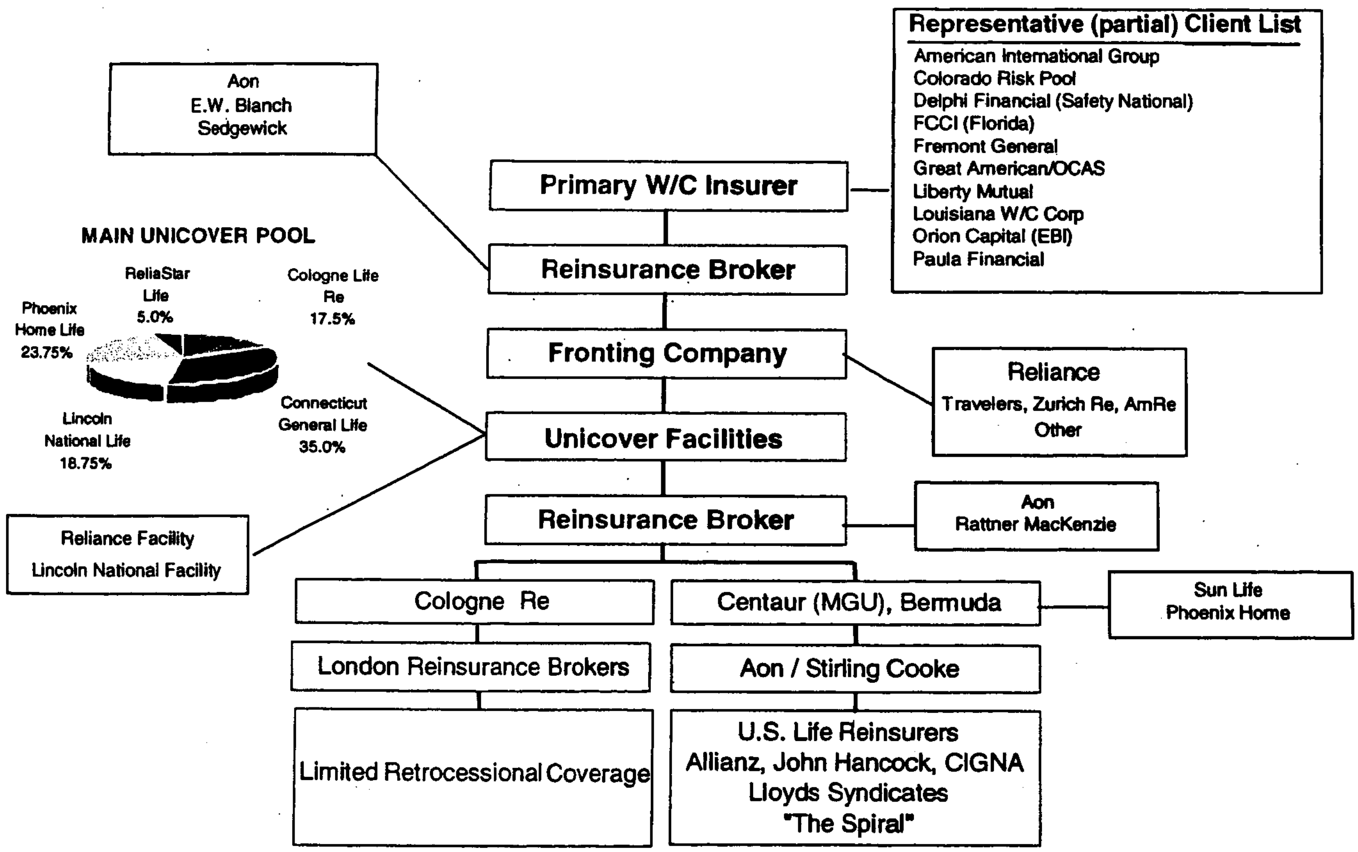
With this action, Sun Life has turned the Unicover/Unibomber game of reinsurance "arbitrage" into "reinsurance roulette"—maybe I get paid, maybe I don't.

In a *letter dated July 15th* from its attorney, Peter R. Chaffetz, of the New York firm Chadbourne & Parke LLP, to Unicover & Aon (with cc: to all the pool members & Reliance), Sun Life demanded *"arbitration against Unicover and its pool and facility companies*." The relevant paragraph in the letter is:

maximum pre-tax gross loss against $1.2BB of capital) to Phoenix (it needs time) may dictate its strategy. Cologne Life Re, we expect, could make similar arguments if Warren Buffett wants to. Remember: Phoenix & Cologne are also both in the Main Unicover Pool while Sun Life is not in the Pool.

2. What will the myriad high priced lawyers advise their (re)insurer clients to do? *Will the premium dollars stop flowing and start going into escrow*? We expect so. With no provisions in the contracts for such action are the contracts still valid?
3. *Will the Facility Members, and most importantly Reliance, be able to take credit for "reinsurance collectible" from Sun Life given the current action*? What happens with the second quarter GAAP reports & statutory filings of the various parties involved in the dispute(s)? *What will the auditors do*? This issue will, in our opinion, prove more important for publicly traded (re)insurers than the ultimate strength of their legal position.
4. Given recent developments, and the range of expected losses, it's fairly straightforward to undertake the "what if's" as to the outcome of the dispute(s). *How will the regulators and rating agencies react to the growing litigation and its implications*? We live in a world where developments occur in "real time."
5. Movement/Action on a "global settlement." Now that Sun Life's position is clear, talks can occur.

UNICOVER MANAGERS FLOW CHART



WHAT WOULD A "GLOBAL SETTLEMENT" LOOK LIKE? Looking to demutualize, Sun Life wants to put the Unicover issue behind it. Mr. Gee seemed to be signaling a willingness to discuss a settlement with a comment to Best Week, *"I think there is going to be some kind of an attempt to get an industry solution. We've kind of pulled the plug, if you will, and I don't think it's to anyone's advantage at our level to drag things out."*

Before thinking about a "Global Settlement" one has to consider/understand the economics to the various participants in the Unicover saga. Looked at another way, *who won and who lost*? For a "Global Settlement" to occur the "winners" have to make the "losers" lose less. The basis for our analysis, with minor rounding and the inclusion of the projected economic gain to Reliance and Kemper/Delphi, is our analysis in IBNR Weekly #25. We start with $2.6BB of premium involved (on $8.0BB of original underlying w/c premium) and reinsurance premiums of approximately $680MM.

Were the multi-year "Unicover" policies to (1) be legally valid—no "paperwork" issues, (2) go full term, and (3) generate a "net" 90% combined ratio to the Pool *and* were all the reinsurance to pay the list of winners -- our rough outline of the magnitude (before time value of money) would approximate:

IBNR INSURANCE WEEKLY #27 (Volume VI)

Evening of Monday July 5th, 1999

****** FORGET JULY 1ST. ALLIANZ LIFE (UNICOVER) LAWSUIT DELAYED UNTIL AT LEAST SEPTEMBER 1ST ******

Phoenix Home Life, Sun Life of Canada, Aon and Allianz have all agreed, and the court has so ordered, <u>a stay of all proceedings in the case until September 1, 1999</u> [responses had been due July 1st]. The reasons given were:

(1) "The subject of this dispute involves alleged reinsurance circumstances that are still evolving and the parties are still determining the nature and extent of their business positions."

(2) "Allianz and Defendants in this action wish to avoid the time and expense associated with the preparation of a Rule 26(f) report* at this juncture." [*A Rule 26(f) report relates to a required early meeting of parties to discuss the nature of their claims and defenses, to discuss the possibility of settlement and to discuss what discovery will be made as required by other procedural rules].

(3) Defendants "would like additional time to answer or otherwise move" with respect to the lawsuit.

IBNR INSURANCE WEEKLY #25 (Volume VI)

Evening of Sunday June 20th, 1999

******WILL THE CONTRACT(S) HOLD? ALLIANZ SUES TO RESCIND COVER(S) SUPPORTING UNICOVER RETRO******

<u>Executive Summary</u>: Allianz Life Insurance Company of North America, a reinsurer of Centaur Managers in Bermuda (John Cackett), was recently informed (March 3rd—two days after the "story" broke) it had assumed (through the reinsurance of Centaur Managers) a major portion of the retrocessional coverage for the now infamous Unicover Managers Facilities. The alleged Allianz Life exposure (which "stunned" them) arises out of Centaur having written the majority of the direct retrocessional program for Unicover Managers (75%+ of the exposure, we estimate) on behalf of Sun Life of Canada & Phoenix Home Life of Hartford—for which Centaur (MGU) held "binding authority."

After returning the $1.2MM of premium to Sun Life & Phoenix on April 19th, Allianz Life filed suit. <u>The suit</u>, now against Sun Life, Phoenix Home, and AON currently resides in Federal Court in MN where <u>Allianz seeks to: (a) "rescind reinsurance agreements" with Sun & Phoenix or</u> (b) "an award of damages against [Sun & Phoenix] and their authorized agent, a reinsurance intermediary [AON]." The suit alleges, "The size and nature of the portfolio of risks now purportedly ceded to Allianz under those agreements are materially different than the size and nature of the portfolio that was represented to induce Allianz to enter into the reinsurance agreements." The 45 page complaint, which in its initial form appears stronger to us than the Odyssey Re suit, goes into the <u>alleged</u> "misrepresentations and/or material non-disclosures" in great detail. Allianz suggests it now believes its <u>exposure could "increase by tens, if not hundreds, of millions of dollars over what Allianz was led to believe it's potential liability was under the agreements</u>." Having heard (read) only one side (Allianz's), we look forward to reading the legal responses from Sun Life & Phoenix which are due to be filed no later than July 1st (unless the parties agree to arbitrate or "stand still").

The merits of the case notwithstanding, <u>the legal action represents the first significant "crack" in the reinsurance program supporting approximately $2.6BB [multi-year] of workers' compensation "carve out" reinsurance premium underwritten by the Unicover Managers</u> facilities (three). It was only a matter of time. As we have outlined in prior writings, the entire Unicover program was based upon "arbitrage" and the use/abuse of cheap/naive reinsurance capacity. The greater fool theory at work—the ultimate "gross" (before spiral) underwriting loss to the Unicover Managers Facilities retrocessional reinsurance program we now estimate at a <u>minimum</u> of $1.3BB against reinsurance premium of approximately $675MM.

<u>We believe Sun Life of Canada is the critical player in how events play out from here</u>. Any hope for a "global settlement," in our view, must recognize the importance of Sun Life of Canada. Once Sun Life makes a move, things should get clearer. We find it interesting Sun Life: (a) canceled the "non cancelable" three year reinsurance contract in question on January 25th, (b) apparently, according to market sources, has not been paying premiums to its own retrocessionaires related to this contract. Given all the players involved, and the allegations made, <u>the Allianz lawsuit would appear to us to increase the probability of "problems" with the ability to fully collect all reinsurance supporting the Unicover facilities</u>. Who will pay remains the $64 question.

<u>If</u> there are additional problems with the Unicover retrocessional program(s), the following might develop: (1) Lawsuits might get going in earnest as those (re)insurers currently paying lawyers to research their position, and currently taking a "wait and see" attitude, seek remedies/posture in the courts. (2) The "fronting" carriers for the $2.6BB of business (Reliance assumed more than $1.0BB as did the main "Pool" members) might retain unexpected underwriting exposure to unprofitable business. (3) The rating agencies and regulator(s) will be forced to act as "cash" slows/stops while litigation takes its time—but statutory balance sheets can't reflect "late" receivables.

Fifteen weeks later and we still don't know (for sure) who the "fools" are.

Our Summary: To the non lawyer and non insurance operator (like the jury Allianz Life seeks to trial the case to), the claim as presented boils down to *one simple assertion—We were bagged or "the victim of a fraudulent bait and switch"*. Here's why according to Allianz Life:

(1) The defendants, given their longstanding relationship(s) with Allianz Life (principally Centaur & Aon as agents for Sun/Phoenix), knew/understood the balanced book of low frequency reinsurance business Allianz was interested in writing—AON's Roger Smith, for example, had placed over 100 contracts with Allianz.

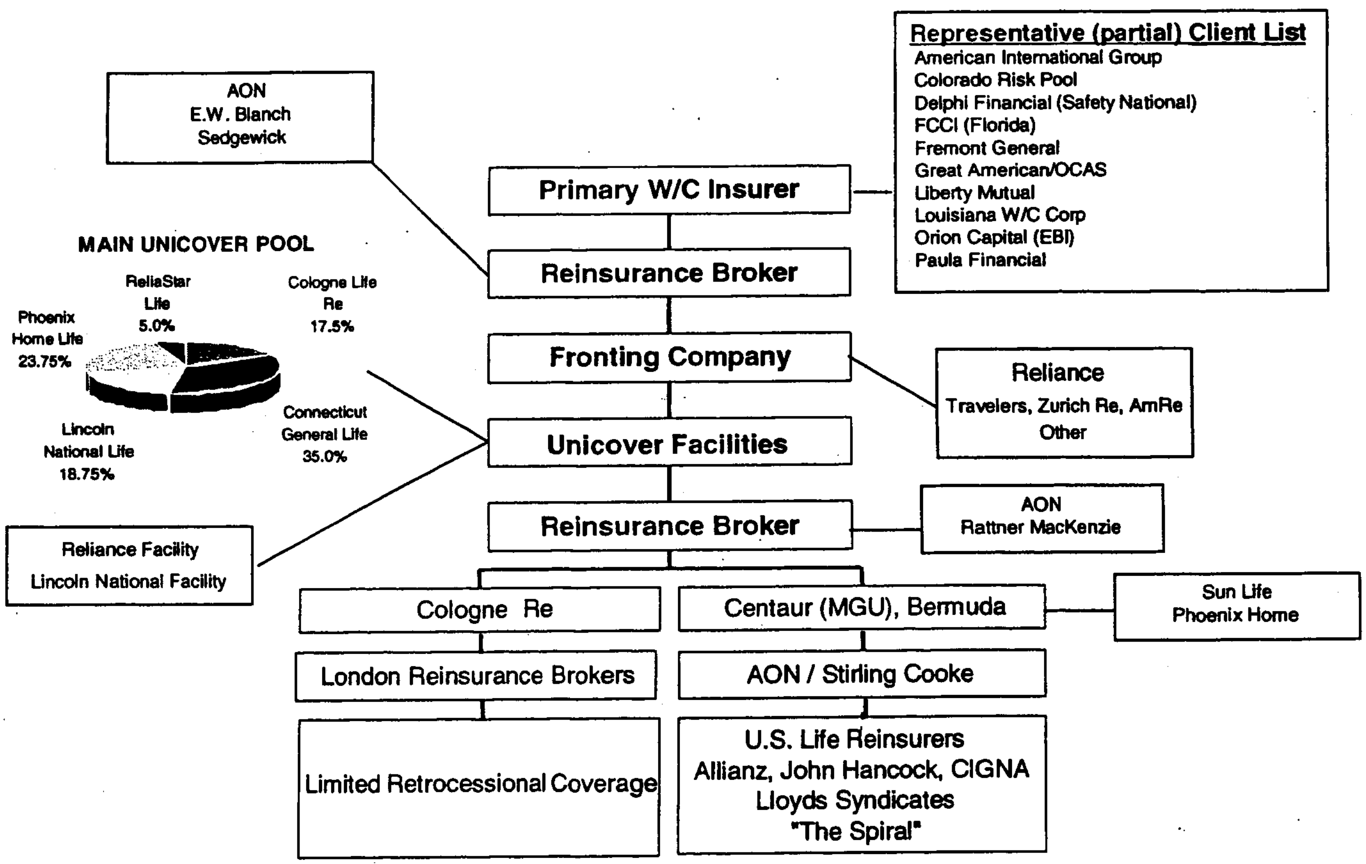
(2) Allianz Life employees, on multiple occasions over several years, asked *specific* questions as to type of business being written and the ongoing volume relative to initial projections.

(3) The defendants, through AON's Smith, repeatedly gave assurance the business written/to be written did/would meet Allianz's criteria and the volume would be in line. Further, specific assurances were given the writings did *not* include a large volume/percentage of workers' compensation carve out exposures.

(4) AON, specifically Roger Smith, according to the complaint, repeatedly provided wrong/inaccurate information over several years related to underlying exposures and volume. Only on March 4th 1999, after the Unicover story was in the press, did Mr. Smith orally inform Allianz that he, Smith, had been given inaccurate information by Mr. Cackett of Centaur which he in turn passed on to Allianz. Mr. Smith, as one of the reinsurance brokers for the Unicover Facilities, will have to explain why he was unaware of the underlying exposures which he/AON placed with Centaur.

(5) Allianz suggests it now believes its *exposure could "increase by tens, if not hundreds, of millions of dollars over what Allianz was led to believe it's potential liability was under the agreements*."

UNICOVER MANAGERS FLOW CHART



TIMETABLE AS OUTLINED IN ALLIANZ LIFE LAWSUIT: (except indented twice where we added information)

- *1990-1996*: Allianz reinsures Lloyds syndicate 957– John Cackett (later of Centaur Managers) is the lead underwriter. Roger Smith placed syndicate 967 business of Cackett's with Allianz.
- *1995*: Allianz invests corporate capital in Lloyd's syndicate 957.
- 1996 Duncanson & Holt/UNUM buys syndicate 957, Cackett no longer lead underwriter, forms startup-Centaur
- *Sept 18th 1996*: Aon's Roger Smith faxes one page slip placing information for risk excess treaty to Lisa Blume, an Allianz underwriter. Placing information: "We are only covering the excess of loss business, and the estimated subject premium for this class for the period hereon is $9,000,000." 8% rate on line (based upon experience of book of business at syndicate 957). Term 10/1/96-12/31/97 = 15 months.

- *December 31st, 1997*: Risk Excess treaty expires by its terms without renewal.
- *March 30th, 1998*: Aon issues final placement slips to Allianz on Variable Quota Share treaty.
- *April 9th, 1998*: Allianz signs placement slips for Variable Quota Share treaty.
- *"Late 1998"*: Allianz heard rumors that Centaur had written large amounts of workers' comp carve out business with Unicover. Blume and Rasmussen of Allianz, independently, contact Smith to confirm that Allianz had no Unicover exposures. Smith orally represented, in separate conversations, that Allianz had no Unicover exposure under any treaties involving business written by Centaur.
- *"Early 1999"*: Media reports that Unicover had written a high volume of comp carve-out business and that risks had been underpriced by as much as 30-40%.
- *February 28th, 1999*: IBNR Weekly #9, dated Sunday evening the 28th but arriving via fax on Monday the 1st of March, provides 1st detailed account of Unicover Manager & W/C "Carve Out" Situation.
- *March 1st, 1999 [Monday]*: Rasmussen of Allianz calls Smith to reconfirm that Allianz had no Unicover exposure on Centaur treaties. Smith again represented Allianz had no such exposure.
- *March 3rd, 1999*: Tom Lynch, Tom Barta, Erik Rasmussen of Allianz have conversation with John Cackett of Centaur in which Cackett states for first time (1) Allianz did in fact have Unicover exposures from business written by Sun/Phoenix. (b) The premium volume had increased substantially. The complaint alleges, "Cackett alleged that the Unicover whole account treaties effective March 1, 1997 had been ceded into the Risk Excess and Surplus Share treaties. Cackett also stated that these Unicover whole account covers were canceled and rewritten effective December 1, 1997, as three-year contracts. Contrary to all prior representations, Cackett contended that Allianz had exposure for these Unicover three year whole account treaties under the Risk Excess treaty. This information stunned Allianz, given the repeated prior representations to the contrary."
- *March 3rd, 1999*: Smith faxes memorandum to Hartley, Centaur employee confirming Aon's understanding "from May last year (1998) . . . that no Unicover business would be ceded to reinsurance placed by Aon Re because of the increase in volume. This had been communicated to retrocessionaires."
- *March 4th, 1999*: Smith confirms (orally) to Lynch, Barta and Rasmussen of Allianz that Cackett had confirmed to him several months earlier that Allianz had no exposure to Unicover whole account program. Smith also stated Centaur had never notified Aon of any change in its original $9MM premium estimate for the Risk Excess Treaty.
- *"March 1999"*: Allianz tries to review Aon's and Centaur's records at their respective offices and was denied access to various original records and copies of underwriting and correspondence files. While at the AON offices Amy George, of AON, again reconfirmed that the Unicover 12/1/97 three year whole account treaties were not to be ceded to Allianz's treaties.
- *April 19th, 1999*: $1.2MM of premium returned to Sun Life & Phoenix Home by Allianz.
- *April 24th, 1999*: Initial lawsuit filed in State Count in Minnesota against Sun Life, Phoenix by Allianz Life.
- *May 19th, 1999*: First Amended Complaint filed to include AON Re.
- *May 24th, 1999*: Suit moved to U.S. Federal Court at request of Sun Life of Canada.
- *May 26th, 1999*: Allianz, Sun Life & Phoenix agree to July 1st date for response (usually only 20 days).

UPDATE OF UNICOVER FACILITIES LOSS ESTIMATE--$1.3BB AT A MINIMUM? 15 weeks ago we estimated a gross underwriting loss of $1.0BB to $2.0BB for the 3 direct retrocessional writers of the Unicover Facilities (Sun Life, Phoenix, Cologne) for business *already* written. Keep in mind the actual industry loss will be higher than this gross loss figure due to the impact of the "spiral"--commissions (usually 10%) that are paid each time business is reinsured. While we now have *significantly* more information, and more specific information than we had initially, the estimate still looks right on (We sincerely appreciate all the unsolicited offers to be "helpful" we've received. It seems everyone wants to provide us with information and their view of how to interpret it—if you haven't yet Email: vj@IBNR.com).

	Multi-Year	
Total Gross Premium Volume of Primary Insurer(s)	$ 8,000	Represents approx. 16% of total industry w/c premium
Ceded To Unicover Facilitie(s)*	$ 2,600	
Ceding Commissions To Primary Insurers (35%)	$ 910	
Gross Writings of Unicover Facilities After Cede	$ 1,690	
Reinsurance Broker Commissions (2.5%)	$ 65	
Unicover Managers MGU Fee (7.5%)	$ 195	Unicover also gets 25% of profits below 92.5% CR
Reinsurance For Occ. Disease and Cumulative Trauma	$ 20	
Reinsurance Premium For Primary Retro**	$ 680	Covering all losses from 10K to 500K per claim
Estimated Net Writings of Unicover Facilities	$ 730	